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No. 63.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

S. B. HEININGER, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF OF AMICUS CURIAE.

HENRY J. RICHARDSON,
Amicus Curiae.

JOHN LEWIS KELLY,
Of Counsel.

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BRIEF OF AMICUS CURIAE.

This brief, with the consent of counsel for both parties, is filed by the undersigned as *amicus curiae* because the decision of the case will control or influence the decisions of many other cases which involve a kindred question, in some of which the undersigned is interested as counsel.

QUESTION INVOLVED.

The question involved in the instant case is whether legal expenses incurred in opposing a fraud order issued by the Post Office Department against the taxpayer are deductible for income tax purposes, or are to be disallowed solely

because the final outcome of the litigation in which said expenses were incurred was against said taxpayer.

STATEMENT.

The facts have been fully stated in the brief for petitioner and respondent.

SUMMARY OF ARGUMENT.

The revenue laws are enactments to raise money by taxing individuals, trusts, associations and corporations on net income as defined by law and not on their gross income.

There are no statutory limitations on the deduction of legal expenses under section 23(a) of the Revenue Acts of 1936 and 1938 based on the outcome of litigation in which the legal expenses were incurrd.

Only in an extreme case is the doctrine of "public policy" as a judicial limitation on the deduction of expenses otherwise allowed by section 23(a) warranted, and the case at bar is not such a situation.

ARGUMENT.

1. The Revenue Laws are Enactments to Raise Money by Taxing Individuals, Trusts, Associations and Corporations on Net Income as Defined by Law and Not on Their Gross Income.

The elemental point stated requires, of course, no citation in support of its fundamental correctness. But it is a reminder that while some may argue as to the scope of the Sixteenth Amendment, even to claiming that it permits the taxation of gross income, nevertheless, the Congressional scheme of taxation is confined to taxing net income, and the denial of deductions allowed by statute in determining net income amounts to the taxation of gross income contrary to the statutory plan, no matter what legalistic basis or "public policy" may be said to sanction such interpretation.

Petitioner, as an introductory argument in his brief, states (P. B. p. 6):

> At the very outset it should be borne in mind that, since deductions from gross income are a matter of legislative grace, the taxpayer has the burden of establishing his right to the deduction. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440; *White* v. *United States*, 305 U. S. 281, 292.

The Court may be interested in an answer to such an argument which comes from the pen of Professor Erwin N. Griswold, and is to be found in a commentary published in June of this year entitled "An argument against the doctrine that deductions should be narrowly construed as a matter of legislative grace." 56 Harvard Law Review 1142.

Professor Griswold initially points out in his note that in *Gould* v. *Gould*, 245 U. S. 151 (1917) the rule was laid down, which taxpayers have often cited, that in case of doubt taxing statutes "are construed most strongly against the Government and in favor of the citizen." He then shows that *White* v. *United States*, 305 U. S. 281, 292 (1938) ended the influence of the cited passage from *Gould* v. *Gould*, *supra*. He then comments as to the citation given by petitioner from this Court's opinion in the *New Colonial Ice Co.* case as follows:

> Meanwhile, however, another aphorism has grown up which seems directly analogous to the rule of *Gould* v. *Gould* and equally unsound. This is to be found in the recent decision of the Supreme Court in Interstate Transit Lines v. Comm'r [decided June 1943], where the Court refers, as the keystone of its opinion, to "the now familiar rule that an income tax deduction is a matter of legislative grace and the burden of clearly showing the right to the claimed deduction is on the taxpayer." This rule in its strict form is of very recent origin. Apparently the first expression in terms of "legislative grace", is found in *New Colonial Ice Co.* v. *Helvering* [292 U. S. 435, 440 (1934)]. There may be some reason to think that the statement there had its roots in the group of cases involving depletion

in the primitive stages of our tax laws. For the most part, though, the earlier cases involving deductions seem to have gone no further than a statement of the burden of proof which generally lies on taxpayers. But the sweeping rule of the *New Colonial Ice* case has since been frequently cited or quoted. An indication of the potency of this approach to the construction of deduction provisions may possibly be found in the fact that the decisions in all but one of these cases went against the taxpayer.

Although the *New Colonial Ice* formula is a "now familiar rule" and is cited by Government lawyers in their briefs as glibly as taxpayers' lawyers once relied on *Gould* v. *Gould*, it has never been fully considered by the Court. Taken literally, it would mean that Congress may deny all deductions and impose a tax on gross income. This is a large question about which there may be reasonable doubts, even today. Could Congress, for example, impose the tax on the entire proceeds from the sale of property without any allowance for the cost of the property? Could it deny deductions for all wages paid? But there is no need to resolve such questions, nor to deny that Congress has very great power over the deductions which are allowed. *The fact remains that Congress has never sought to tax gross income*, and the whole structure and history of the income tax makes it plain that the intention of Congress to allow deductions has been just as clear as its intention to tax income.

2. There are no Statutory Limitations on the Deduction of Legal Expenses Under Section 23(a) of the Revenue Acts of 1936 and 1938 Based on the Outcome of Litigation in Which the Legal Expenses Were Incurred.

Professor Griswold in the note cited and quoted from previously makes some other comments on the deduction of ordinary and necessary expenses generally. Some of these remarks are as follows (56 Harvard Law Review 1142, 1145):

> There would seem to be room to think that the approach exemplified by the passage from the *New*

Colonial Ice case has already resulted in considerable distortion of our income tax law. Much of the controversy has revolved round the matter of deductions for business expenses.

The statute allows the deduction of "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . .". This language has been unchanged since the Revenue Act of 1918. Apparently it finds its origin in provisions which were included in the Act of August 27, 1894. The legislative history of these provisions gives clear evidence that they were intended to have broad application; and no action of Congress since that time has ever indicated a contrary intention. There would seem to be every reason why the words of the statute should be given a broad construction so as to achieve the obvious purpose of Congress to tax net business income. It is true that the expenses must be "ordinary and necessary" but these words are given full and adequate function when they are used to separate capital expenditures from current expenses, on the one hand, and when they eliminate such things as illegal expenditures or wholly unrelated expenses, on the other. But the Court, by bearing down on "ordinary and necessary" and on "trade or business" and reducing these phrases to sterile bones, has done much to thwart the purpose of Congress to impose the tax on net incomes.

While some provisions of the revenue laws may be aimed at the indirect accomplishment of some social, economic or political purpose, nevertheless the statutory provisions are not texts on morals and have as a primary objective the function of taxing net income. Judge Sibley of the Fifth Circuit, in *Alexandria Gravel Co.* v. *Commissioner*, 95 F. (2d) 615, put these thoughts this way (p. 616):

> The revenue laws of the United States are not over-squeamish. By the broad definition of gross income, income arising from an illegal business is taxed even though the illegality be one declared by the Constitution itself. *United States* v. *Sullivan*, 274 U. S. 259. The provisions of the statute fixing the deductions to be regarded in arriving at the net income which alone

is taxed, 26 U. S. C. A. §23, are as broad and unqualified as those defining the taxable gross income.

The deduction of legal expenses is within or without these twenty words of section 23(a) of the Revenue Acts of 1936 and 1938 which permits the deduction from gross income of—

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . ."

There are no words of limitation in the foregoing statutory language limiting the deduction of legal or other expenses based on the outcome of litigation. Any limitation on the deduction of legal expenses paid or incurred during a taxable year of one carrying on a trade or business must be—

(a) by way of a particular construction placed upon the words "ordinary and necessary" or

(b) by reading into the statutory language the word "lawful" before the words "trade or business" thus limiting deductions to those incurred in lawful trades or businesses.

As to (b) above, the case of *United States* v. *Sullivan*, 274 U. S. 259, 47 S. Ct. 607, 71 L. Ed. 1037, 51 A. L. R. 1020, stands in the way of reading the word "lawful" before the words "trade or business" even constructively. That case held that although the taxpayer was engaged in a business which violated the National Prohibition Act his net income was subject to taxation. It was pointed out at 274 U. S. 263 that gains or profits "of any business" were taxed. Moreover it was pointed out that in section 213(a) of the Revenue Act of 1921 defining income and the provision then before the court, the definition was similar to that of the earlier Act of October 3, 1913 (c. 16 Section II, B, 38 Stat. 114, 167) "except that the word 'lawful' is

omitted before 'business' in the passage just quoted." Thus Congress showed its intention to tax the income from unlawful as well as lawful businesses. Consequently ordinary and necessary expenses of an unlawful business would be deductible under the statutory scheme of taxing only net income. *Steinberg* v. *United States*, 14 F. (2d) 564.

It is apparent from this bit of income tax history that it cannot now be said either that the income from unlawful businesses is not taxable or that deductions from the income of such businesses are to be denied. The one question left open in *United States* v. *Sullivan*, *supra*, in the matter of deductions from gross income was the deduction of such an expenditure as for bribery, which conceivably might be denied as being against public policy. Bribery is not involved in the case at bar, nor was lobbying, which was the subject matter involved in *Textile Mills Securities Corp.* v. *Commissioner*, 314 U. S. 326, 62 S. Ct. 272.

To hold that legal expenses will be deductible only if a taxpayer is vindicated from some alleged violation of law is to impose a penalty upon defending oneself which is not in keeping with American traditions of encouraging the employment of counsel and presenting ones case to an impartial tribunal.

In *Kornhauser* v. *United States*, 276 U. S. 145, 48 S. Ct. 219, this Court in holding that fees paid to attorneys for defending an action for accounting instituted by a former partner was deductible, said (p. 152)—

> * * * it was an "ordinary and necessary" expense, since a suit ordinarily and, as a general thing at least, necessarily requires the employment of counsel and payment of his charges * * *

In discussing the grounds for such deductions it was said—

> The basis of these holdings seems to be that where a suit or action against a taxpayer is directly con-

> nected with, or as otherwise stated (Appeal of Backer, 1 B. T. A. 214, 215) proximately resulted from, his business, the expense incurred is a business expense within the meaning of section 214 (a) subd. 1, of the act.

It is submitted that *Kornhauser* v. *United States* still states sound principles of tax law. Where legal expenses are incurred which are directly connected with a business they are ordinary and necessary expenses of that business and are, therefore, deductible. To read into the statutory concept a limitation on such deductions based on the outcome of litigation is not only unwise but unwarranted. Congress has not changed the text of section 23(a) as to the deduction of "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . ." since this language was put in the Revenue Act of 1918 as section 214(a) which is the provision interpreted in the *Kornhauser* case.

While we have this Court's reference to the meaning of "ordinary and necessary" in *Welch* v. *Helvering*, 290 U. S. 111, 54 S. Ct. 8, and *Deputy* v. *du Pont*, 308 U. S. 488, 60 S. Ct. 363, it is to be noted that what constitutes "ordinary and necessary" expenses has not been circumscribed by a decision of this Court or in any regulation by the qualification that the deduction of such expenditures may depend upon the outcome of litigation and Congress has imposed no such limitation.

The Court below, in the case at bar, pointed out that—

> We are asked, in the guise of construing the words "ordinary and necessary" to amend the statute. In other words, to engage in a little judicial legislation. We decline the invitation.

Other courts have also refused "to engage in a little judicial legislation" (*Foss* v. *Commissioner*, C. C. A.—1, 75 F. (2d) 376) but not so the Second Circuit, which accepted the invitation extended in *Burroughs Bldg. Mate-*

rial Co. v. *Commissioner*, 47 F. (2d) 178, and has continued to do so through *National Outdoor Advertising Bureau* v. *Helvering*, 89 F. (2d) 881.

The rationale of *National Outdoor Advertising Bureau* v. *Helvering*, in denying a deduction in part for certain legal expenses, was that it was not a necessary expense, thus not within the requirement of §23(a) but presumably an ordinary one since the court did not attempt any rationalization on this point. The theory that such legal expenses were not necessary was not precisely stated in the opinion. The closest approach to such a statement seems to be the following excerpt:

> If it is never necessary to violate the law in managing a business, it cannot be necessary to resist a decree in equity forbidding violations, except in cases where an injunction is unjustified. There is indeed less to be said for spending money in that way than in defending a criminal prosecution for the decree by hypothesis will do no more than forbid what the taxpayer ought not to do anyway. Moreover, when as here, the decree is entered in a suit by the United States, there would seem to be all the elements of an estoppel; and, that aside, the consent is an acknowledgment of the proximity of the danger, as we have already said.

Many arguments against the rule of *National Outdoor Advertising Bureau* v. *Helvering* may be cited; it also may be scored as a poorly worked out judicial limitation on the deduction of legal expenses. The following comment from 54 Harvard Review 852, 855, seems to be one proper criticism of the rule of the cited case for it is pointed out that—

> • • • several courts have evolved the reasoning that it is unnecessary to defend any action by the government if you are guilty; any money expended in so doing is wasted, and therefore not "necessary" [citing *National Outdoor Advertising Bureau* v. *Helvering*]. But this fallaciously assumes a mechanical jurisprudence in which one can predict with certainty how cases will be decided; the taxpayer must be gifted with

a foresight which is not generally required by the current judicial definition of "necessary." Therefore these decisions must be justified if at all by a broad public policy similar to that underlying the disallowance of fines and penalties. However, the amount of the fine is an expression of what the exaction for wrongdoing should be, and disallowance may be necessary to make the taxpayer actually bear the burden of the fine. But this does not apply to legal expenses, and since legal fees may often be many times larger than the fine, the effect will be to invoke an additional penalty for wrongdoing completely unrelated in dollar amount to the statutory exaction.

An additional difficulty in disallowing expenditures which reflect the cost of wrongdoing is that an arbitrary line is drawn between actions by the government and actions by individuals. Thus expenses resulting from the unsuccessful defense of such torts as fraud, negligence, malpractice, breach of fiduciary duty, and patent infringements may be deducted. It has been said that torts are a necessary incident of modern business life, while statutory violations are not; and it may be that there is less public necessity in deterring wrongs redressed by civil actions; yet such generalities hardly justify such an arbitrary rule of law.

The rule of *National Outdoor Advertising Bureau* v. *Helvering*, that where a criminal prosecution under the Sherman Anti-Trust Act ends in a consent decree only the cost of defending so much of the case as the prosecution is not successful, is deductible, has been criticised on other grounds. For example, in the most recent edition of Mertens "Law of Federal Income Taxation" (1942 Ed.) the rule of the cited case has been scored on the ground that "Where the issue is settled by a consent decree, such decree may frequently deal with matters not directly connected with the criminal prosecution." (Vol. 4, p. 385) In support of this statement the following note appears:

> See, e. g., U. S. v. Ford Motor Co., et al. CCH Trade Regulation Service, Par. 25,171. In addition it overlooks the practical aspect that taxpayers may

consent to decrees because of the cost of defending the criminal action, because they are not doing and do not intend to do the acts covered by the decree and hence are willing to be enjoined. The suggestion that the consent to the decree means that there was an appreciable possibility that the enjoined acts would be done is unrealistic in many cases.

With the present number and complexity of federal and state statutes and rules and regulations promulgated thereunder having the force and effect of law, no business could be transacted if business men in this country had to get clearance from counsel on each and every decision they wish to make. Yet every decision made, every operation undertaken, raises the possibility of a violation of one or another of the myriad laws and regulations or amendments thereto. One can review with profit this situation a little further. This Court may well take judicial notice of the fact that prior to the establishment of the Federal Register Act of July 26, 1935 (49 Stat. 500 as amended; 44 U. S. C. ch. 8B) Congress found that people were being charged with the violation of all kinds of rules, regulations and orders that they not only never heard of but could not find in print. Yet if such a person had employed counsel to defend themselves in the ordinary and necessary course of their business but it turned out that under some obscure regulation having the force and effect of law they had violated such regulation, then under the rule contended for by petitioner in this case such legal expense would not be deductible, but if it had been ruled that no violation of said regulation had occurred, then the legal expenses incurred would have been deductible.

Here is another situation existing today. Examine a copy of the Federal Register of any date and it will be noticed that in many instances many of the war agencies such as the W. P. B., O. P. A. and even "old line" departments, are not only issuing new rules and regulations daily but that they are so constantly amending existing regula-

tions that it is almost impossible to tell from day to day just what the law is in relation to a given point and therefore impossible for counsel to advise what is and what is not permissible under the law of the land. Thus over the head of every ordinary business enterprise in the country there is the lurking possibility of a charge of the violation of one or another rule or regulation. Again, the defense of such a charge will not constitute a deductible expense under the rule contended for by petitioner in this case if by any chance the taxpayer violated such rule or regulation.

Again, the rule urged by petitioner is not realistic in the light of the following situation: A reputable manufacturer and distributor in advertising its products, let us say, makes certain claims which the Federal Trade Commission believes unjustified in the light of their investigations and accordingly they charge the concern with "unfair practice in commerce" under the Federal Trade Commission Act. The advertiser disagrees with the Commission's viewpoint and accordingly counsel is employed to defend it. Let us further suppose that the point in issue is a very close one requiring considerable expert testimony because there is a considerable variance in the opinion of scientific men on the question involved. After the array of witnesses and other evidence has been placed before the Commission a decision in due course will be rendered which can only be overturned in the federal courts if there is no substantial evidence in support thereof. Based on its decision in such a close case as that outlined, the rule contended for by petitioner would deny a deduction for legal expenses to a taxpaper to the extent that the decision of such a tribunal was against the contentions of the taxpayer or resulted in a stipulation of revised practices—consent decree.

The recent language of Judge Learned Hand in the *Associated Press* decision (New York Times, October 7, 1943) points up very clearly the harshness in the narrow

interpretation which the petitioner proposes be given to the term "ordinary and necessary" in relation to deductible business expenses. In the *Associated Press* case, the complaint alleged the existence of a combination in restraint of interstate commerce. But as Judge Hand pointed out, not only must there be a restraint but it must be unreasonable—

> * * * and that never has been, and indeed in the nature of things never can be, defined in general terms.
>
> Courts must proceed step by step applying retroactively the standard proper for each situation as it comes up * * *. Decision in each case depends upon a comparative appraisal of the values of the object sought to be accomplished by the actors' conduct, the effects of such conduct and of the object on competition and on business enterprise, and the opposing interests of the actors in freedom of action and of the person harmed in freedom of opportunity to do business. * * *
>
> Certainly such a function is ordinarily "legislative." * * * We have here a legislative warrant, because Congress has incorporated into the anti-trust acts the changing standards of the common law, and by so doing has delegated to the courts the duty of fixing the standard for each case.

As Judge Hand points out, decisions of courts or administrative tribunals as to the legality of acts challenged under the broad scope of present day legislative prohibitions are in effect retroactive legislative enactments applied to the particular case in dispute. When a transaction which has been carried out in good faith to further the interests of a business enterprise is challenged as being subject to the impact of the process described by Judge Hand, clearly the expense of meeting that challenge is an ordinary and necessary expense of the business; the retroactive process should not further be extended to change this classification depending upon the conclusion reached by a court or an administrative body, frequently by divided

vote, as to the legality of the transaction. The legislative policy which, in the case of an administrative body, makes such a conclusion binding and not subject to reversal if supported by any substantial evidence, regardless of the weight of the evidence considered as a whole, further underlies the importance of not reading into the tax law the limitations here urged by the petitioner.

The law recognizes that those accused of violating its provisions are entitled to counsel; even in the case of confessedly guilty parties, public policy encourages the retention of counsel to see that the requirements of due process are complied with and that a correct application of the law's provisions has been made. It is inconsistent with this policy to hold that an unsuccessful defense by a business enterprise of its way of life is not an ordinary and necessary expense when, as in most instances, it is impossible, in advance of a decision of some tribunal, to prophesy whether taxpayer's conduct will be found to be on one side or the other of what is ultimately determined to be lawful.

In view of the multiplicity of restrictive legislative and administrative regulations affecting business, the uncertainties arising from the lack of exact definitions in the controlling standards, the difficulty of construing new statutes and regulations, and the possibility of technical violations, despite the utmost good faith and the support of most reputable authority, the rule contended for by the petitioner in this case would place an unbearable burden on the conduct of business. Under present-day tax rates, business may well be unable to properly defend itself if this must be done at the risk of having the expense disallowed.

There is nothing in the tax law which requires any such harsh result. The statute permits the deduction of "ordinary and necessary" expenses. A reasonable interpretation of this provision does not require that a business man, who, in the conduct of his enterprise, in good faith

takes some action which a court or administrative body may later decide to be within a prohibited area, be placed in the same category as a giver of bribes.

Only in an extreme case is the doctrine of "public policy" as a judicial limitation on the deduction of expenses otherwise allowed by section 23(a) warranted, and the case at bar is not such a situation. The deduction of legal expenses does not stand on the same footing, for example, as the payment of bribes or of lobbying expenses which this Court considered in the *Textile Mills Securities Co.* case, *supra.* Nor are such expenses in the same class as fines and penalties, as is pointed out in 12 Fordham Law Review 8 (January 1943), where it was said (p. 19):

> The soundness of the decisions which disallow as deductions fines and penalties, whether imposed for innocent mistake or for serious infractions, is not questioned. A fine or a money penalty is a form of punishment, and public policy demands that the offender bear the full brunt of it. To allow an income tax deduction for a fine would place the Government in the anomalous position of itself bearing a portion of the burden. But this is not so as to the incidental legal expenses. Does public policy in all cases require that since fines are disallowed, legal expenses in litigating the question of liability therefor should also be disallowed? If one abandon the role of idealist, and realistically approach the problem of squaring the complexities of the conduct of present day industrial business with the countless technical provisions of existing regulatory laws, each with its concomitant fine or penalty, one is less inclined to insist upon that brand of logic which demands that since a fine is non-deductible, legal expenses incident to the determination of liability therefor must likewise be disallowed, and which further demands that until the question of liability for the fine is determined, the question of the deductibility of the legal expenses must remain in abeyance.

Still another distinction may be made between the disallowance of fines and penalties as a matter of public pol-

icy as contrasted with the disallowance of legal expenses. Fines and penalties which find their sanction in federal laws represent the expressed will of Congress that a penalty shall be levied for certain acts. However, when a court disallows a tax deduction for legal expenses because of an unsuccessful defense of some act, the court is, in effect, also levying another fine or penalty, and this without the sanction of Congress. Again Congress may have deliberately avoided providing any fine in connection with the act restrained; to deny legal expense in defending and determining the legality of the act would be to supply the fine which Congress refrained from imposing.

It may thus be seen that resort to the doctrine of "public policy" as a basis for the disallowance of a deduction should be very limited. It is indeed a very unusual case where there is any justification for the application of this doctrine and certainly the case at bar is not such a situation.

Respectfully submitted

HENRY J. RICHARDSON,
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JOHN LEWIS KELLY,
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SUPREME COURT OF THE UNITED STATES.

No. 63.—October Term, 1943.

Commissioner of Internal Revenue, Petitioner, vs. S. B. Heininger.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[December 20, 1943.]

Mr. Justice Black delivered the opinion of the Court.

The question here is whether lawyer's fees and related legal expenses paid by respondent are deductible from his gross income under Section 23(a) of the Revenue Acts of 1936 and 1938 as ordinary and necessary expenses incurred in carrying on his business.[1]

The fees and expenses were incurred under the following circumstances. From 1926 through 1938 respondent, a licensed dentist of Chicago, Illinois, made and sold false teeth. During the tax years 1937 and 1938 this was his principal business activity. His was a mail order business. His products were ordered, delivered, and paid for by mail. Circulars and advertisements sent through the mail proclaimed the virtues of his goods in lavish terms. At hearings held before the Solicitor of the Post Office Department pursuant to U. S. C. Title 39, §§ 259 and 732, respondent strongly defended the quality of his workmanship and the truthfulness of every statement made in his advertisements, but the Postmaster General found that some of the statements were misleading and some claimed virtues for his goods which did not exist. Thereupon, on February 19, 1938, a fraud order was issued forbidding the Postmaster of Chicago to pay any money orders drawn to respondent and directing that all letters addressed to him be stamped "Fraudulent" and returned to the senders. Such a

[1] Revenue Act of 1936, c. 690, 49 Stat. 1658.
"Sec. 23. Deductions from Gross Income.
"In computing net income there shall be allowed as deductions:
"(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, . . ."
Section 23(a) of the Revenue Act of 1938, c. 289, 52 Stat. 460, is identical with Section 23(a) of the Revenue Act of 1936.

sweeping deprivation of access to the mails meant destruction of respondent's business. He therefore promptly sought an injunction in a United States District Court contending that there was no proper evidential basis for the fraud order. On review of the record that Court agreed with him and enjoined its enforcement. The Court of Appeals drew different inferences from the record, held that the evidence did support the order, and remanded with instructions to dissolve the injunction and dismiss the bill. *Farley* v. *Heininger,* 105 F. 2d 79. Respondent's petition for certiorari was denied by this Court on October 9, 1939. *Heininger* v. *Farley,* 308 U. S. 587.

During the course of the litigation in the Postoffice Department and the courts respondent incurred lawyer's fees and other legal expenses in the amount of $36,600, admitted to be reasonable. In filing his tax returns for the years 1937 and 1938 he claimed these litigation expenses as proper deductions from his gross receipts of $287,000 and $150,000. The Commissioner denied them on the ground that they did not constitute ordinary and necessary expenses of respondent's business. The Board of Tax Appeals[2] affirmed the Commissioner, 47 B.T.A. 95, and the Circuit Court of Appeals reversed and remanded. 133 F. 2d 567. We granted certiorari because of an alleged conflict with the decisions of other circuits.[3]

There can be no doubt that the legal expenses of respondent were directly connected with "carrying on" his business. *Kornhauser* v. *United States,* 276 U. S. 145, 153; cf. *Appeal of Backer,* 1 B.T.A. 214; *Pantages Theatre Co.* v *Welch,* 71 F. 2d 68. Our enquiry therefore is limited to the narrow issue of whether these expenses were "ordinary and necessary" within the meaning of Section 23(a). In determining this issue we do not have the benefit of an interpretative departmental regulation defining the application of the words "ordinary and necessary" to the particular expenses here involved. Cf. *Textile Mills Securities Corp.* v. *Commissioner,* 314 U. S. 326, 338. Nor do we have the benefit of the independent judgment of the Board of Tax Appeals. It did

[2] Section 504(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 957. U. S. C. Title 26, § 1100 changes the name of the Board of Tax Appeals to "The Tax Court of the United States."

[3] Helvering v. National Outdoor Advertising Bureau, Inc., 89 F. 2d 878 (C.C.A. 2); Helvering v. Superior Wines & Liquors, Inc., 134 F. 2d 373 (C.C.A. 8).

not deny the deductions claimed by respondent upon its own interpretation of the words "ordinary and necessary" as applied to its findings of fact. Cf. *Hormel* v. *Helvering*, 312 U. S. 552, 555, 556. The interpretation it adopted was declared to be required by the Second Circuit Court's reversal of the Board's view in *National Outdoor Advertising Bureau, Inc.* v. *Commissioner*, 32 B.T.A. 1025.[4]

It is plain that respondent's legal expenses were both "ordinary and necessary" if those words be given their commonly accepted meaning. For respondent to employ a lawyer to defend his business from threatened destruction was "normal"; it was the response ordinarily to be expected. Cf. *Deputy* v. *du Pont*, 308 U. S. 488, 495; *Welch v. Helvering*, 290 U. S. 111, 114; *Kornhauser* v. *United States*, *supra*. Since the record contains no suggestion that the defense was in bad faith or that the attorney's fees were unreasonable, the expenses incurred in defending the business can also be assumed appropriate and helpful, and therefore "necessary." Cf. *Welch* v. *Helvering*, *supra*, 113; *Kornhauser* v. *United States*, *supra*, 152. The government does not deny that the litigation expenses would have been ordinary and necessary had the proceeding failed to convince the Postmaster General that respondent's representations were fraudulent.[5] Its argument is that dentists in the mail order business do not ordinarily and necessarily attempt to sell false teeth by fraudulent representations as to their quality; that respondent was found by the Postmaster General to have attempted to sell his products in this manner; and that therefore the litigation expenses, which he would not have incurred but for this attempt, cannot themselves be deemed ordinary and necessary. We think that this reasoning, though plausible, is unsound

[4] Helvering v. National Outdoor Advertisement Bureau, Inc., *supra*, Note 3. In that case the taxpayer had incurred legal expenses defending a suit begun by the United States to enjoin violations of the Sherman Act. It had successfully defended part of the charges against it, but had agreed to the entry of a consent decree of injunction as to the balance. The Board held that all of the legal expenses were ordinary and were proximately connected with the taxpayer's business, and that to allow them as deductions would not be against public policy. The Circuit Court reversed as to that portion of the expenses attributable to the consent decree. See also Helvering v. Superior Wines & Liquors, Inc., *supra*, Note 3, where the Board was reversed for allowing a taxpayer in the liquor business to deduct lawyer's fees incurred in connection with a compromise of liability for civil penalties assessed for improper bookkeeping under U. S. C. Title 26, §§ 2857 *et seq.*

[5] See Note 8, *infra*.

in that it fails to take into account the circumstances under which respondent incurred the litigation expenses. Cf. *Welch* v. *Helvering, supra,* 113, 114. Upon being served with notice of the proposed fraud order respondent was confronted with a new business problem which involved far more than the right to continue using his old advertisements. He was placed in a position in which not only his selling methods but also the continued existence of his lawful business were threatened with complete destruction. So far as appears from the record respondent did not believe, nor under our system of jurisprudence was he bound to believe, that a fraud order destroying his business was justified by the facts or the law. Therefore he did not voluntarily abandon the business but defended it by all available legal means. To say that this course of conduct and the expenses which it involved were extraordinary or unnecessary would be to ignore the ways of conduct and the forms of speech prevailing in the business world. Cf. *Welch* v. *Helvering, supra,* 115. Surely the expenses were no less ordinary or necessary than expenses resulting from the defense of a damage suit based on malpractice, or fraud, or breach of fiduciary duty. Yet in these latter cases legal expenses have been held deductible without regard to the success of the defense.[6]

The Bureau of Internal Revenue, the Board of Tax Appeals, and the federal courts have from time to time, however, narrowed the generally accepted meaning of the language used in Section 23(a) in order that tax deduction consequences might not frustrate sharply defined national or state policies proscribing particular types of conduct. A review of the situations which have been held to belong in this category would serve no useful purpose for each case should depend upon its peculiar circumstances.[7] A few examples will suffice to illustrate the principle involved. Where a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction

[6] Malpractice: C. B. V. 1, 226; Fraud: Helvering *v.* Hampton, 79 F. 2d 358; Breach of fiduciary duty: Isaac P. Keeler *v.* Commissioner, 23 B.T.A. 467. See also the examples of deductible expenses set forth in Kornhauser *v.* United States, 276 U. S. 145.

[7] For a collection and analysis of many of the cases see Note (1941) 54 Harv. L. Rev. 852; 4 Mertens, Law of Federal Income Taxation (1942) §§ 25.35-25.37, 25.102-25.105.

for its payment.[8] Similarly, one who has incurred expenses for certain types of lobbying and political pressure activities with a view to influencing federal legislation has been denied a deduction.[9] And a taxpayer who has made payments to an influential party precinct captain in order to obtain a state printing contract has not been allowed to deduct their amount from gross income.[10] It has never been thought, however, that the mere fact that an expenditure bears a remote relation to an illegal act makes it non-deductible. The language of Section 23(a) contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible. And the brief of the government in the instant case expressly disclaims any contention that the purpose of tax laws is to penalize illegal business by taxing gross instead of net income. Cf. *United States* v. *Sullivan*, 274 U. S. 259.

If the respondent's litigation expenses are to be denied deduction, it must be because allowance of the deduction would frustrate the sharply defined policies of 39 U. S. C. §§ 259 and 732 which authorize the Postmaster General to issue fraud orders. The single policy of these sections is to protect the public from fraudulent practices committed through the use of the mails. It is not their policy to impose personal punishment on violators; such punishment is provided by separate statute,[11] and can be imposed only in a judicial proceeding in which the accused has the benefit of constitutional and statutory safeguards appropriate to trial for a crime. Nor is it their policy to deter persons accused of violating

[8] Great Northern Ry. Co. *v.* Commissioner, 40 F. 2d 372; Bonnie Bros., Inc. *v.* Commissioner, 15 B.T.A. 1231; Burroughs Bldg. Material Company *v.* Commissioner, 47 F. 2d 178; Appeal of Columbus Bread Company, 4 B.T.A. 1126. A taxpayer who has been prosecuted under a federal or state statute and convicted of a crime has not been permitted a tax deduction for his attorney's fee. Estate of Thompson *v.* Commissioner, 21 B.T.A. 568; Burroughs Bldg. Material Company *v.* Commissioner, *supra*. But if he has been acquitted, a deduction has been allowed. Commissioner *v.* People's-Pittsburgh Trust Co., 60 F. 2d 187; cf. Citron-Byer Co. *v.* Commissioner, 21 B.T.A. 308; Hal Price Headley *v.* Commissioner, 37 B.T.A. 738. Cf. Helvering *v.* Superior Wines & Liquors, Inc., *supra*, Note 3.

[9] Textile Mills Securities Corp. *v.* Commissioner, 314 U. S. 326, 338. Cf. Commissioner *v.* Sunset Scavenger Co., Inc., 84 F. 2d 453.

[10] Rügel *v.* Commissioner, 127 F. 2d 393. Cf. Kelley-Dempsey & Company *v.* Commissioner, 31 B.T.A. 351, where deduction was denied for the expense of commercial extortion.

[11] Criminal Code, Section 215; 25 Stat. 873; 35 Stat. 1130; U. S. C. Title 18, § 338.

their terms from employing counsel to assist in presenting a bona fide defense to a proposed fraud order. It follows that to allow the deduction of respondent's litigation expenses would not frustrate the policy of these statutes; and to deny the deduction would attach a serious punitive consequence to the Postmaster General's finding which Congress has not expressly or impliedly indicated should result from such a finding. We hold therefore that the Board of Tax Appeals was not required to regard the administrative finding of guilt under 39 U. S. C. §§ 259 and 732 as a rigid criterion of the deductibility of respondent's litigation expenses.

Whether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances. Except where a question of law is unmistakably involved a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling,[12] should not be reversed by the federal appellate courts.[13] Careful adherence to this principle will result in a more orderly and uniform system of tax deductions in a field necessarily beset by innumerable complexities. Cf. *Hormel* v. *Helvering, supra.* However, as we have pointed out above, the Board of Tax Appeals here denied the claimed deduction not by an independent exercise of judgment but upon a mistaken conviction that denial was required as a matter of law. We therefore affirm the judgment of the Circuit Court of Appeals reversing and remanding the cause to the Board of Tax Appeals.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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12 See Welch *v.* Helvering, 290 U. S. 111, 115.

13 Cf. Helvering *v.* F. & R. Lazarus & Co., 308 U. S. 252, 255; Dobson et al. *v.* Commissioner, Nos. 44-47, decided this day.